Supreme Court, U.S.
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No. 02-

IN THE

Supreme Court of the United States

D.L. CROMWELL INVESTMENTS, INC., LLOYD BEIRNE, DAVID S. DAVIDSON, ERIC S. THOMAS, and MATTHEW GREENWALD,

Petitioners,

v.

NASD REGULATION, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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58 pp

QUESTIONS PRESENTED

Rule 65(a)(2) of the Federal Rules of Civil Procedure permits consolidation of a preliminary injunction hearing with a trial on the merits before or after the commencement of the hearing. This court has held that such consolidation cannot occur without clear and unambiguous notice given either before the hearing commences or at a time which still affords the parties a full opportunity to present their respective cases. *University of Texas v. Camenisch*, 451 U.S. 390, 395, 101 S. Ct. 1830, 1834 (1981). Numerous courts have interpreted the foregoing notice requirement to include an allowance of time for parties to conduct discovery. In this case, the Second Circuit held that notice of consolidation was not required prior to the conclusion of the presentation of all the evidence at a preliminary injunction hearing because the petitioners were constructively on notice that the disposition of the preliminary injunction application would likely be dispositive of the entire case. The Second Circuit further held that, by virtue of seeking preliminary injunctive relief, the petitioners waived any rights they may have had to conduct discovery upon consolidation.

The question presented is whether constructive notice of consolidation of a preliminary injunction hearing with a trial on the merits is in accord with Rule 65(a)(2) and prior precedent of this court and other courts and whether formal notice of consolidation given after the conclusion of presentation of all the evidence at a preliminary injunction hearing is properly given without leave to conduct discovery.

STATEMENT PURSUANT TO RULE 29.6

Petitioner D.L. Cromwell Investments, Inc. states that it has no corporate parent and that no publicly held company owns 10% or more of D.L. Cromwell Investments, Inc.'s stock.

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OPINIONS ENTERED IN THIS CASE

The order and opinion of the Court of Appeals for the Second Circuit (Appendix ("App.") 1a-16a) is officially reported as: *D.L. Cromwell Investments, Inc. Lloyd Beirne, David S. Davidson, Eric S. Thomas and Matthew Greenwald v. NASD Regulation, Inc.*, 279 F.3d 155 (2d Cir. 2002).

The order and opinion of the District Court for the Southern District of New York (App. 17a-33a) is officially reported as: *D.L. Cromwell Investments, Inc., Lloyd Beirne, David S. Davidson, Eric S. Thomas and Matthew Greenwald v. NASD Regulation, Inc.*, 132 F. Supp. 248 (S.D.N.Y. 2001).

STATEMENT OF JURISDICTION

The Court of Appeals entered its order of affirmance on February 1, 2001. A timely petition for rehearing en banc was filed in this case on or about February 15, 2002. On May 8, 2002, the Court of Appeals denied the application for rehearing. The jurisdiction of this court is accordingly invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED IN THIS MATTER

The focus of this matter turns on the interpretation and application of Rule 65(a)(2) of the Federal Rules of Civil Procedure.

The statute provides:

> Before or after the commencement of the hearing of an application for a preliminary injunction, the court may order the trial of the action on the merits to be advanced and consolidated with the hearing

> of the application. Even when this consolidation is not ordered, any evidence received upon an application for a preliminary injunction which would be admissible upon the trial on the merits becomes part of the record on the trial and need not be repeated upon the trial. This subdivision (a)(2) shall be so construed and applied as to save to the parties any rights they may have to trial by jury.

STATEMENT OF THE CASE

On January 30, 2001, Petitioners filed the Complaint in this action seeking a permanent injunction enjoining NASD Regulation, Inc. ("Regulation") from compelling their testimony under the guise of its "private" status (when it covertly was acting as an agent of the government) in violation of Petitioners' Fifth Amendment rights against self-incrimination. The Petitioners simultaneously moved by order to show cause for a preliminary injunction because Regulation had scheduled on-the-record interviews for the week of February 12, 2001, which made expedited relief necessary. The district court ordered Regulation to show cause at a hearing on February 9, 2001 why a temporary restraining order and preliminary injunction should not issue.

After oral argument, the district court found that Petitioners had made a showing sufficient to require Regulation to present evidence at an evidentiary hearing on the motion for a preliminary injunction. The Court temporarily stayed the on-the-record interviews and ordered Regulation to present its evidence on February 15, 2001. The hearing was noticed solely as a preliminary injunction hearing, no expedited discovery was ordered, and the Petitioners were not advised that a consolidation was contemplated.

On February 15, 2001, the district court required that Regulation offer its evidence first to rebut the showing previously made by Petitioners. Petitioners had no advance disclosure of the substance of the testimony of Regulation's witnesses and were therefore limited in their ability to cross-examine those witnesses. When Regulation rested, the district court accepted the affidavits previously filed by the Petitioners in the matter as their evidence. At that point, the evidentiary hearing was completed. The district court then announced for the first time its intention to consolidate the trial on the merits with the preliminary injunction hearing pursuant to FRCP Rule 65(a)(2) because it reasoned that a denial of the preliminary injunction effectively would render the action moot. Petitioners objected on the ground that they had not had any discovery. The district court dismissed this objection, commenting that "this litigation is not a discovery proceeding." A53.2.[1] Notwithstanding the district court's comment, Petitioners again requested that they be granted two weeks to conduct expedited discovery and collect evidence. A53.3-53.4. Since the on-the-record interviews scheduled for the week of February 12, 2001 had been stayed, Petitioners did not face irreparable harm until the next scheduled on-the-record interview on March 8, 2001. A53.5. The district court rejected this proposal. A53.4.

On February 26, 2001 — twenty seven days after the complaint was filed and two weeks after the hearing — the district court issued a Memorandum Opinion setting forth findings of fact and rendering a final judgment against Petitioners. The decision was entered on February 27, 2001. On March 9, 2001, Petitioners filed a motion for a new trial

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1. References to A___ are to the Joint Appendix filed with the Second Circuit Court of Appeals.

based upon newly discovered evidence, and that motion was denied by the district court on March 12, 2001. Petitioners filed a notice of appeal with the clerk of the district court on March 23, 2001. On March 26, 2001, Petitioners filed a motion for a stay pending appeal. The Second Circuit denied the motion for a stay on April 24, 2001.

On September 19, 2001 the Second Circuit heard oral argument on the appeal. On February 1, 2002 the Court of Appeals issued a decision affirming the judgment of the District Court. The Second Circuit held that petitioners had constructive notice of the consolidation because, upon seeking emergency relief, petitioners should have known that a denial of the motion for a preliminary injunction would likely be dispositive of the case. Recognizing that such notice might have been "too 'oblique' to clear[ly] and unambiguous[ly] notice' the hearing as a trial on the merits," the Court of Appeals further held that Petitioners were not prejudiced by the consolidation because they could not point to specific evidence they were prevented from presenting. App. 10a. The Court also held that although Petitioners objected to consolidation and repeatedly requested the opportunity to take discovery, the prejudice Petitioners suffered from their inability to obtain discovery was brought on by "[their] own tactical choice to pursue immediate relief not by the consolidation decision." App. 11a.

REASONS FOR GRANTING THE WRIT

Certiorari Is Warranted Because the Decision below Conflicts with Decisions of this Court and of Other Circuits.

It is well settled that the consolidation of a hearing on a preliminary injunction with a trial on the ultimate merits cannot occur without "clear and unambiguous notice [of the Court's intent to consolidate the trial and the hearing] either *before* the hearing commences *or at a time which will still afford the parties a full opportunity to present their respective cases*." (Emphasis supplied) *University of Texas v. Camenisch*, 451 U.S. 390, 395, 101 S. Ct. 1830, 1834 (1981). The requirement of timely, clear and unambiguous notice of consolidation stems from the fact that the purpose of a preliminary injunction is limited to preserving the status quo and the evidentiary proof required at a preliminary injunction is therefore ". . . less complete than in a trial on the merits. A party thus is not required to prove his case in full at a preliminary injunction hearing (citations omitted)". *Id.* at 394. As a consequence of the substantial difference between the evidentiary proof required at a preliminary injunction hearing and a trial on the merits, a party must be given a meaningful opportunity to prepare for a trial on the merits if the Court elects to consolidate the preliminary injunction hearing with a trial. This, of course, necessitates advance, clear and unambiguous notice and, if necessary, an opportunity to conduct discovery. *Pughsley v. 3750 Lake Shore Drive Co-op Bldg.*, 463 F.2d 1055 (7th Cir. 1972).

In those instances where notice of consolidation of a preliminary injunction with a trial on the merits is not given prior to rendering a decision on the merits, the determination

of the trial court has consistently been reversed throughout the various Circuits. *T.M.T. Trailer Ferry, Inc. v. Union De Tronquistas De Puerto Rico, Local 901*, 453 F.2d 1171 (1st Cir. 1971); *Carribean Produce Exchange, Inc. v. Secretary of Health and Human Services*, 893 F.2d 3 (1st Cir. 1989); *Capital City Gas Company v. Phillips Petroleum Company*, 373 F.2d 128 (2d Cir. 1967); *Wilson v. Zarhadnick*, 534 F.2d 55 (5th Cir. 1976); *Air Line Pilots Ass'n, Intern. v. Alaska Airlines, Inc.*, 898 F.2d 1393 (9th Cir. 1990); *American Federation of Government Emp., AFL-CIO, Local 3319, United States Deputy Marshalls v. Colburn*, 531 F.2d 314 (5th Cir. 1976).

Similarly, when notice of consolidation is either insufficiently clear or is given without affording a party adequate time and opportunity to present its case on the trial of the merits, the notice is also legally insufficient and proper ground for reversal. In *Pughsley*, which was cited by this Court in its decision in *Camenisch*, the Seventh Circuit Court of Appeals reversed the District Court's determination to dismiss the plaintiff's complaint after the conclusion of a preliminary injunction hearing because the District Court failed to provide clear and timely notice of consolidation. The District Court had stated at the conclusion of the first day of a two day injunction hearing that the plaintiff should put in its "total case". However, no formal order of consolidation was issued by the District Court and no opportunity was ever given to the plaintiff to conduct discovery. Judge Stevens, writing for the Seventh Circuit, held that the reference by the Court to putting in the "total case" was inadequate to afford the plaintiff sufficient opportunity to prepare for a trial on the merits. Judge Stevens further expressed the general view that consolidation should not occur unless a party is given the opportunity to engage

in discovery and that a party applying for emergency relief should not be deemed to have waived their right to discovery:

> A litigant applying for a preliminary injunction should seldom be required either to forego discovery in order to seek emergency relief, or to forego a prompt application for an injunction in order to prepare adequately for trial.

Pughsley v. 3750 Lake Shore Drive Co-op Bldg., 463 F.2d at 1057-1058.

The opinion of Judge Stevens in *Pughsley* was not only cited by this Court in *Camenisch*, but it has been the standard by which a notice of consolidation has been evaluated in other circuits as well. In *Gellman v. State of Md*, 538 F.2d 603 (4th Cir. 1976), the Fourth Circuit reversed the District Court's dismissal of a complaint upon the conclusion of a preliminary injunction hearing because the Court failed to provide adequate notice of consolidation and failed to permit discovery by the plaintiff. The District Court had stated at the end of the second day of a three day hearing that "if there are other issues to be resolved, they will also be resolved". Citing *Pughsley*, the Fourth Circuit found such notice was inadequate and that it was inherently prejudicial to rule on the merits of plaintiff's action at the preliminary injunction hearing when the plaintiff had not had an opportunity to engage in discovery. The Court stated as follows:

> [T]he plaintiff should have some reasonable opportunity to develop additional evidence through discovery, a right denied him by the premature order terminating his action. To grant judgment on the merits under Rule 65(a)(2)

> without any notice of such intention until the conclusion of the evidentiary hearing on the motion for a preliminary injunction . . . without requiring answers to interrogatories or permitting any discovery in a case which, on the pleadings at least, is not frivolous, comes perilously close to a violation of due process.

Gellman, 538 F.2d at 606.

The Fourth Circuit in *Gellman*, endorsed the following procedure recommended by a leading text as the method by which consolidation should take place:

> Doubt as to the propriety of consolidation will be minimized if the trial court gives the parties advance notice of the proposed action or, if consolidation is ordered at the hearing, the parties are permitted to request additional time to assemble their entire presentation on the merits.

11 Wright & Miller, *Federal Practice and Procedure* § 2950, p. 488.

The rule articulated in *Pughsley* and by this Court in *Camenisch* was also cited with approval by the Second Circuit in *Woe v. Cuomo*, 801 F.2d 627 (2d Cir. 1986) when the Second Circuit reversed that portion of the District Court's decision which converted an application for a preliminary injunction into a permanent disposition on the merits. In the absence of the requisite clear and unambiguous notice of consolidation, the plaintiffs' counsel had proceeded with a preliminary injunction hearing on the mistaken belief that the Court was prepared to rule only on the question of

preliminary injunctive relief. This was manifested by the fact that counsel presented no evidence at the hearing apart from that obtained during cross-examination. The Second Circuit found that the absence of clear and unambiguous notice of consolidation was prejudicial and remanded the case for a trial, reasoning as follows:

> The District Court acted prematurely when it granted permanent relief based upon what it viewed as 'undisputed evidence' without notifying appellants of its intent to do so. The giving of formal notice ensures both that a party may avail himself of every opportunity to present evidence pertinent to his position and that all genuine issues of fact are before the Court.

Woe v. Cuomo, 801 F.2d at 629.

In the instant case, it is beyond dispute that the District Court did not indicate its intent to consolidate the preliminary injunction hearing with the trial on the merits until after the evidentiary hearing was already concluded. Up until that point in time, the plaintiffs' counsel had received no indication from the Court that it would be consolidating the preliminary injunction with a trial on the merits. However, once confronted with the belatedly expressed intention of the District Court to consolidate the proceeding, the plaintiffs' counsel asked for a two week adjournment to engage in expedited discovery. This request was in accord with the view articulated in *Pughsley*, *Camenisch*, *Gellman* and set forth in a leading treatise quoted above. Nonetheless, the Court rejected the plaintiffs' request.

In affirming the District Court's dismissal of the complaint upon consolidation, the Second Circuit Court of Appeals ruled that it was the plaintiffs' "own tactical choice to pursue immediate relief," not consolidation, that accounted for plaintiffs' inability to obtain discovery. Specifically, the Court stated that the plaintiffs could not seek a two week adjournment to engage in discovery since the plaintiffs had previously contended that they required a preliminary injunction due to the immediate irreparable harm that would befall the plaintiffs unless the Court intervened immediately.[2] This reasoning by the Court constituted a substantial deviation from the rule articulated in *Pughsley*, *Camenisch* and *Gellman* in that the Court concluded that the plaintiffs' request for a preliminary injunction constituted a waiver of the plaintiffs' right to pursue discovery in the event of consolidation.

The ruling of the Second Circuit also deviated from the repeatedly stated rule that notice of consolidation must be given clearly and unambiguously and in a sufficiently timely manner to permit the plaintiffs an opportunity to prepare for a trial on the merits. Although the District Court's notice of consolidation was not given until all of the evidence had been presented at the preliminary injunction hearing, the Second Circuit nonetheless found that the plaintiffs were constructively on notice that the injunction hearing would be the equivalent of a trial on the merits because the

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2. The Second Circuit confused the irreparable harm issue with the ultimate merits of the action. The absence of immediate irreparable harm would, at best, justify a denial of the application for a preliminary injunction. It could not justify the dismissal of the entire action. By dismissing the entire action, the court precluded the plaintiffs from ever having their day in court and litigating the issue of the denial of their constitutional rights under the Fifth Amendment.

determination of whether the NASD was a state actor would necessarily be dispositive of the entire case. In further support of this conclusion, the Second Circuit referred to the District Court's announcement six days before the hearing that "[t]he issue is the state action issue; essentially, whether these 8210 requests are fairly attributable to the government". *D.L. Cromwell Investments, Inc. v. NASD Regulation, Inc.*, 279 F.3d at 160. However, the contention that the plaintiffs were constructively on notice of the consolidation of the injunction with a trial on the merits is simply not in accord with the prior ruling of this Court in *Camenisch* or the rulings cited above, all of which provide that notice must be clear and unambiguous, not oblique. Nor was the Court's ruling in accord with the portion of the Court's holding in *Camenisch* where this Court noted that the determination of issues at a preliminary injunction hearing cannot, under any circumstances, constitute a determination of the issues that are ultimately to be tried on the merits.

The Second Circuit also departed from established precedent when it concluded that the plaintiffs ultimately could not establish prejudice due to the inadequate notice of consolidation. The Second Circuit specifically reasoned that, in order to establish such prejudice, the plaintiffs had to demonstrate that they were precluded from presenting specific evidence at the consolidated trial on the merits. However, this conclusion was also not in accord with the prior rulings of this Court and other Circuits in that, as noted above, the Courts have determined that prejudice exists by virtue of being deprived of the opportunity to engage in discovery and to have a meaningful opportunity to present one's case at a trial on the merits. In fact, this point was underscored by the authority cited by the Second Circuit in support of its conclusion that no prejudice befell the

plaintiffs in this case by reason of the inadequate notice of consolidation. Indeed, in *Abraham Zion Corp. v. Lebow*, 761 F.2d 93, 101 (2d Cir. 1985), for example, the plaintiff objected to notice of consolidation given prior to the conclusion of the hearing but after the presentation of plaintiffs' evidence. While the objection was overruled by the Court, the plaintiffs were nonetheless given permission to file an amended complaint, conduct additional discovery during a thirteen day adjournment of the hearing, and to recall a witness for additional testimony. *Id.* at 99-101. As a consequence of the leave granted to the plaintiffs to amend the complaint and conduct additional discovery as well as recall a witness at the hearing, the Second Circuit concluded that the plaintiff could not be prejudiced. In contrast, none of those opportunities were afforded the plaintiffs in this case.

In *Irish Lesbian and Gay Organization v. Giuliani*, 143 F.3d 638, 646 (2d Cir. 1998), the Second Circuit found that the appellant could have, but chose not to, appeal the District Court's dismissal of the case on the merits on the ground that the District Court should not have consolidated the preliminary injunction application with a trial on the merits. Clearly then, the determination of the Second Circuit in *Irish Lesbian and Gay Organization*, could not be used as a precedent for a rule permitting anything other than clear and unambiguous notice of consolidation. Similarly, in *Reese Pub Co., Inc. v. Hamption Intern. Communications, Inc.* 620 F.2d 7, 12 (2d Cir. 1980), the appellant repeatedly was given notice of the District Court's intention to consolidate the preliminary injunction hearing with a trial on the merits prior to the close of the hearing. *Id.* at 12. At the close of the hearing, the judge stated that the hearing had just occurred unless there was some disputed question of fact. The appellant did not object; rather it sought to introduce evidence of a "secondary

meaning" of a generic term to establish a trademark. The Court held that appellant was not prejudiced by the District Court's refusal to allow the evidence on this point because the law is clear that a generic term cannot be established as a trademark by proof of secondary meaning. *Id.*

Finally, *Johnson v. White*, 528 F.2d 1228, 1231 (2d Cir. 1975), also is factually distinguishable from this case. In *Johnson*, at the conclusion of the preliminary injunction hearing, the district court ordered consolidation with the trial on the merits. It did not provide any prior notice of its intent to do so. The Second Circuit noted in dicta that the appellants did not object to the District Court's failure to give timely notice of consolidation. *Id.* at 1231. However, this Court reversed on other grounds and did not reach the issue of whether the failure to provide timely notice was error. *Id.*

Importantly, each of the cases which the Second Circuit cited in its decision recognized the necessity of clear and unambiguous notice prior to consolidation and highlights the fact that the lack of such notice constitutes error. In this case, the District Court did not give notice of consolidation until after the hearing and failed to cure the late notice by affording the petitioners a brief period of expedited discovery and therefore the petitioners' rights to due process were violated. The determination of the Second Circuit affirming the District Court's acts as noted above is in conflict with established United States Supreme Court precedent as well as the precedent in other Circuits discussed above.

CONCLUSION

Based upon the foregoing, the petitioners respectfully submit that the instant petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED FEBRUARY 1, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2001

(Argued: September 19, 2001 Decided: February 1, 2002)

Docket No. 01-7301

D. L. CROMWELL INVESTMENTS, INC.,
LLOYD BIERNE, DAVID S. DAVIDSON,
ERIC S. THOMAS, and MATTHEW GREENWALD,

Plaintiffs-Appellants,

—v.—

NASD REGULATION, INC.,

Defendants-Appellees.

Before:

MESKILL, JACOBS, and CABRANES,

Circuit Judges.

Appeal from the judgment of the United States District Court for the Southern District of New York (Kaplan, *J.*) dismissing the complaint seeking an injunction. Appellants argue that their Fifth Amendment rights were violated by the demand made by NASD Regulation, Inc. that appellants submit to on-the-record interviews, and that the district court impermissibly consolidated the hearing of the preliminary injunction motion with the trial on the merits.

Affirmed.

Appendix A

DENNIS JACOBS, *Circuit Judge*:

Plaintiffs-appellants D. L. Cromwell Investments, Inc. ("Cromwell") and individual Cromwell employees, all members of the National Association of Securities Dealers, Inc. ("NASD"), have been the subject of ongoing investigations both by NASD Regulation, Inc. ("Regulation"), which is an investigatory arm of the NASD, and by federal prosecutors. They have sued to enjoin NASD Regulation from compelling them — under threat of sanctions authorized by NASD Rule 8210 — to submit to on-the-record interviews, arguing that NASD Regulation is a willing tool of the prosecutors and that the compelled interviews would therefore violate their Fifth Amendment privilege against self-incrimination.

They appeal from the judgment of the United States District Court for the Southern District of New York (Kaplan, *J.*), rejecting the claim on the finding that Regulation was not a state actor subject to constitutional restraint, but was rather a private party conducting a private investigation. The preliminary injunction hearing was consolidated with the trial on the merits (over Cromwell's objection) after the district court heard testimony from witnesses for both Cromwell and NASD, and before the rendering of the decision.

On appeal, appellants argue essentially: (1) that they were prejudiced by the consolidation because in so doing the court denied their request for a necessary two-week delay to pursue discovery, and erroneously employed the merits-based "preponderance of the evidence" standard of proof rather than the less onerous "serious questions" standard available in

preliminary injunction proceedings; and (2) that the district court erroneously held that because Regulation is not a state actor, it cannot be subject to the Fifth Amendment restraint.

I

Regulation is the regulatory arm of the NASD, a private, not-for-profit, self-regulatory organization registered with the Securities and Exchange Commission ("SEC"), of which appellants are members. Regulation is responsible for "conducting investigations and commencing disciplinary proceedings against [NASD] member firms and their associated member representatives relating to compliance with the federal securities laws and regulations." *Datek Securities Corp. v. National Ass'n of Securities Dealers, Inc.*, 875 F. Supp. 230, 232 (S.D.N.Y. 1995). Regulation's Division of Enforcement ("DOE") conducts regulatory investigations and disciplinary hearings, and imposes sanctions that are subject to multiple layers of administrative and judicial review, including appeals within the NASD, and appeal to the SEC under a *de novo* standard.

One group within the DOE — the Criminal Prosecution Assistance Unit ("the Unit") — assists federal and state authorities in their investigations of securities matters. The Unit's activities are self-contained, and it performs no other function. It is a small department consisting of a lawyer, an examiner, and an investigator. It is sometimes granted access (pursuant to court order) to grand jury materials, which it is required to shield from the rest of the DOE and to not divulge. Its one lawyer, Bruce Bettigole, is occasionally designated a Special Assistant United States Attorney as part

of his duties. *See* 28 U.S.C. § 543 (providing for the appointment of special attorneys to assist United States attorneys).

Notwithstanding the separation of the Unit's duties from those of the DOE, there is some administrative overlap between it and the rest of DOE: Bettigole is subordinate to the Deputy Director and the Director of the DOE; Bettigole shares a secretary with a DOE lawyer; the work-space of the Unit's examiner and its investigator is surrounded by DOE staff; the Unit's telephone, fax, and computer services are shared with the rest of the DOE.

The facts as found by the district court and supported by the record, demonstrate that in October 1998, the DOE opened an investigation concerning Cromwell's involvement in the trading of shares in Pallet Management Systems, Inc. ("Pallet"). Soon after, the United States Attorney for the Eastern District of New York and the FBI opened their own investigations into the same transactions.

In November 1998, the FBI (as part of its investigation) asked the Unit for certain documents concerning Pallet, which the Unit was aware related to Cromwell's involvement in Pallet. The Unit turned over the documents.

In March 1999, a DOE lawyer and a DOE examiner went to Florida to inspect Cromwell's books and gather documents. Soon after, the FBI called the DOE lawyer, who conveyed general information to the FBI concerning the contents of the documents inspected in Florida. In response to a later formal request, the DOE allowed the FBI access to the Cromwell documents.

Appendix A

During the summer of 2000, the U.S. Attorney's Office for the Eastern District of New York and the DOE shared details about the progress of their respective investigations. Specifically, prosecutors divulged to the DOE information from a cooperating witness. Additionally, the DOE and prosecutors learned from each other that they were both investigating Pallet and Cromwell's involvement in Pallet.

At this time, the Unit was assisting the U.S. Attorney's Office in the U.S. Attorney's efforts to secure a search warrant for Cromwell's Brooklyn office. After execution of the warrant by the U.S. Attorney, Bettigole and another Unit staff member reviewed the seized documents to determine whether any were relevant to a separate, long-standing, criminal investigation in which the Unit was involved.

In November 2000, the DOE demanded certain documents from Cromwell. Cromwell responded that many of the requested documents had been seized by federal agents. A DOE staff member then asked Cromwell and the U.S. Attorney's Office for an inventory of the seized documents. Cromwell supplied an illegible copy of the inventory, and the U.S. Attorney's Office told the DOE that the Unit already had the list. The DOE soon obtained a legible inventory from the Unit, and later procured a number of the documents from the U.S. Attorney's Office.

In December 2000, the Unit helped the U.S. Attorney's Office prepare a grand jury subpoena for materials related to Pallet to be served on an entity called Fiserv. The terms of the subpoena allowed Fiserv to comply by electronic transmission, but because of a technological incompatibility

between Fiserv and (both) the FBI and the U.S. Attorney's Office, Fiserv was allowed to comply by transmitting the information to the Unit.

Subsequently, the DOE served demands (pursuant to NASD Rule 8210) for on-the-record interviews of individual appellants. NASD Rule 8210 grants the DOE "the right to . . . require a member . . . to provide information orally, in writing or electronically . . . and to testify at a location specified by [DOE] staff . . . with respect to any matter involved in [an NASD] investigation." NASD Rule 8210(a)(1)(CCH). Appellants commenced this suit to enjoin those demands.

We review the district court's decision to consolidate the hearing for a preliminary injunction with a trial of the action on the merits under Rule 65(a)(2) for abuse of discretion. *Abraham Zion Corp. v. Lebow,* 761 F.2d 93, 102 (2d Cir. 1985). We review the district court's findings of fact for clear error and its holdings of law *de novo. White v. White Rose Food,* 237 F.3d 174, 178 (2d Cir. 2001).

II

Under Fed.R.Civ.P. 65(a)(2), "[b]efore or after the commencement of the hearing of an application for a preliminary injunction, the court may order the trial of the action on the merits to be advanced and consolidated with the hearing of the application." Cromwell argues that in this instance the consolidation of the preliminary injunction hearing with the trial on the merits was an abuse of discretion. *See Abraham Zion Corp. v. Lebow,* 761 F.2d 93, 102 (2d Cir. 1985).

Appendix A

In its strongest formulation, Cromwell's argument is that while it had a fair shot (even without discovery) at securing preliminary relief by raising sufficiently serious questions to show a balance of hardships tipping decidedly in its favor, *see Jolly v. Coughlin,* 76 F.3d 468, 473 (2d Cir. 1996) (internal quotations omitted), it would have needed further weeks of discovery in order to support its heavier burden at a trial on the merits, and that the district court, therefore, should have put off its ultimate decision once the district court had determined that preliminary relief was not warranted, and granted Cromwell's request for an opportunity to pursue its discovery request.

The argument, however, is hard to square with Cromwell's contention, prior to the preliminary injunction hearing, that the question was urgent and could not be deferred. Thus, when Cromwell was seeking a prompt hearing, it argued that Regulation's Rule 8210 demands would cause irreparable harm — there and then — by forcing individual appellants to choose between foregoing their Fifth Amendment privilege (and risking criminal prosecution) or exposing themselves to NASD sanctions.[1] *See Bery v. City of New York,* 97 F.3d 689, 693 (2d Cir. 1996) (holding that a movant for a preliminary injunction "must first demonstrate that it is likely to suffer irreparable harm in the absence of the requested

1. Specifically, Cromwell argued: "Plaintiffs irreparably will be harmed if the preliminary injunction is not issued. . . . Regulation does not deny that . . . [it] will swiftly move to have the individual Plaintiffs barred [from the securities industry] if they do not testify." Plaintiffs' Reply Memorandum of Law in Support of Motion for Preliminary Injunction at 9, 9 n. 7, *D. L. Cromwell v. NASD Regulation,* 01 Civ. 728 (S.D.N.Y. Feb. 8, 2001).

relief"). The irreparable harm was said to arise from individual appellants' refusal to submit to the impending testimony, and the hearing sought was to decide what all parties saw as the sole issue of the case: whether Regulation is a state actor.

The district court, upon recognizing the state action issue as "the whole ballgame," exercised discretion to order consolidation at the close of the hearing. Transcript of Preliminary Injunction Hearing at 115, *D. L. Cromwell v. NASD Regulation,* 01 Civ. 728 (S.D.N.Y. Feb. 15, 2001). Cromwell, anticipating defeat, objected for the first time that an adjudication on the merits would require a two-week delay to pursue discovery, and argued that the delay for it would, in fact, cause *no* immediate harm, because if individual appellants refused to testify, the NASD itself would stay any suspension during the protracted NASD appellate procedure. Sound or not, this argument contradicted the claim of urgency that evidently induced the court to immediately hear the preliminary injunction motion in the first instance.

If the district court had been advised that Cromwell could avoid testifying without immediate suspension while it enjoyed an essentially automatic stay by virtue of the administrative appeals process, the court might have afforded additional time for discovery; at the same time, however, the court might have put off consideration of preliminary relief, or conducted a hearing under less urgent circumstances. In denying a delay for discovery, the district court merely credited Cromwell's original position — based on its initial claim of inflexible urgency — and rejected its later and contradictory argument that the issue would keep almost indefinitely. That decision was not an abuse of discretion.

Additionally, Cromwell maintains on appeal that the district court failed to provide proper notice of its intent to consolidate. *Woe v. Cuomo,* 801 F.2d 627, 629 (2d Cir. 1986) ("Courts may consolidate a trial on the merits with a hearing on a motion for preliminary injunctive relief only after 'the parties . . . receive clear and unambiguous notice [of the court's intent to do so] either before the hearing commences or at a time which will still afford the parties a full opportunity to present their respective cases.') (quoting *Pughsley v. 3750 Lake Shore Drive Cooperative Bldg.,* 463 F.2d 1055, 1057 (7th Cir. 1972)) (alterations in original); *Abraham Zion,* 761 F.2d at 101 (citing *University of Texas v. Camenisch,* 451 U.S. 390, 395 (1981)).

Cromwell, however, was on notice from the outset that its claim hinged on the issue to be decided at the preliminary injunction hearing. The complaint emphasized the Fifth Amendment state actor question and that resolution of that discrete issue controlled disposition of what Cromwell, itself, termed its "very *narrow*" claim for injunctive relief. Complaint at 1, *D. L. Cromwell v. NASD Regulation,* 01 Civ. 728 (S.D.N.Y. Jan. 30, 2001) (emphasis in original).

Moreover, the district court provided additional notice to Cromwell, announcing six days before the hearing that "[t]he issue is the state action issue; essentially, whether these 8210 requests are fairly attributable to the government." Transcript at 22, *D. L. Cromwell v. NASD Regulation,* 01 Civ. 728 (S.D.N.Y. Feb. 9, 2001).

In any event, even if the district court's comments were too "oblique" to "clear[ly] and unambiguous[ly] notice" the hearing as a trial on the merits, *Woe,* 801 F.2d at 629 (citing *Pughsley,* 463 F.2d at 1057), Cromwell cannot demonstrate that it suffered prejudice by consolidation. *Abraham Zion,* 761 F.2d at 101 ("Given the broad discretion accorded the district court by Rule 65(a)(2), the court's order of consolidation will not be overturned on appeal absent a showing of substantial prejudice in the sense that a party was not allowed to present material evidence."); *see also Irish Lesbian and Gay Organization v. Giuliani,* 143 F.3d 638, 646 (2d Cir. 1998) ("[A] failure to . . . notify a party [of consolidation] which results in prejudice is grounds for reversal.").

To show prejudice, Cromwell must point to some relevant evidence that it was "prevented from presenting . . . because of the consolidation." *Reese Pub. Co., Inc. v. Hampton International Communications, Inc.,* 620 F.2d 7, 12 (2d Cir. 1980); *see also Johnson v. White,* 528 F.2d 1228, 1231 (2d Cir. 1975) ("[I]n order to obtain a reversal for such an error, a party must show, not only surprise but 'prejudice' in the sense of having other material evidence to introduce."). On appeal, Cromwell points out that it rested on its affidavits at the close of the hearing — before the district court announced its decision to consolidate. However, Cromwell has not alleged that it would have done otherwise had the district court's intent to consolidate been expressed more clearly. Rather, Cromwell argues that consolidation allowed no interval for *subsequent* discovery. *See, e.g.,* Memorandum of Law in Support of Plaintiffs' Motion for New Trial Pursuant to FRCP 59(a), *D. L. Cromwell v. NASD Regulation,*

01 Civ. 728 (S.D.N.Y. Mar. 9, 2001). Any such prejudice, however, was caused by Cromwell's own tactical choice to pursue immediate relief, not by the consolidation decision.

Moreover, Cromwell's application for a two-week discovery period before a hearing on the merits looks very much like a fishing expedition. On appeal, Cromwell specifies three witnesses it needed to depose: present and former Regulation employees Roger Sherman, Linda Walters, and John Long. However, it failed to make that specific discovery request of the district court either at the hearing on the motion for a preliminary injunction or in its motion for a new trial. At the hearing on the motion for a preliminary injunction, Cromwell asked generally for "two weeks to conduct discovery of the Department of Enforcement and [the Unit] so that we can gain the evidence." Transcript of Preliminary Injunction Hearing at 119, *D. L. Cromwell v. NASD Regulation,* 01 Civ. 728 (S.D.N.Y. Feb. 15, 2001). In its motion for a new trial, Cromwell raises only its alleged recent discovery of the existence and timing of certain cooperating witness statements given to federal prosecutors.

For the reasons stated, we hold that the district court properly consolidated the preliminary injunction hearing with a trial on the merits, and having done so, it correctly analyzed the state actor question under the preponderance of the evidence standard as opposed to the *Jolly* standard. *See Inmates of Attica Correctional Facility v. Rockefeller,* 453 F.2d 12, 24 (2d Cir. 1971) (holding injunctive relief proper "if proved at trial by a fair preponderance of the evidence"); *Jolly,* 76 F.3d at 473.

III

To establish a Fifth Amendment violation, a plaintiff must demonstrate "that in denying the plaintiff's constitutional rights, the defendant's conduct constituted state action." *Desiderio v. National Ass'n of Securities Dealers, Inc.*, 191 F.3d 198, 206 (2d Cir. 1999), *cert. denied*, 121 S.Ct. 756 (2001); *see also United States v. International Bd. of Teamsters*, 941 F.2d 1292, 1295 (2d Cir. 1991). That is because the Fifth Amendment restricts only governmental conduct, and will constrain a private entity only insofar as its actions are found to be "fairly attributable" to the government. *See Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982); *Corrigan v. Buckley*, 271 U.S. 323, 330 (1926).

Actions are "fairly attributable" to the government where "there is a sufficiently close nexus between the State and the challenged action of the regulated entity." *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 351 (1974). That nexus exists either (1) where the state "has exercised coercive power [over a private decision] or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State"; or (2) where "the private entity has exercised powers that are 'traditionally the exclusive prerogative of the State.' " *Blum v. Yaretsky*, 457 U.S. 991, 1004-05 (1982) (quoting *Jackson*, 419 U.S. at 351); *see also Desiderio*, 191 F.3d at 206.

Under the *Blum* test, even heavily-regulated private entities generally are held not to be state actors. *Desiderio*, 191 F.3d, at 206 ("[T]he fact that a business entity is subject to 'extensive and detailed' state regulation does not convert

that organization's actions into those of the state."); *see also Jackson*, 419 U.S. at 350, 95 S.Ct. 449 (holding that extensively regulated public utilities are not state actors).

It has been found, repeatedly, that the NASD itself is not a government functionary. *See, e.g., Desiderio*, 191 F.3d at 206 ("The NASD is a private actor, not a state actor. It is a private corporation that receives no federal or state funding. Its creation was not mandated by statute, nor does the government appoint its members or serve on any NASD board or committee."); *United States v. Shvarts*, 90 F. Supp. 2d 219, 222 (E.D.N.Y. 2000) ("It is beyond cavil that the NASD is not a government agency; it is a private, not-for-profit corporation. It was not created by statute. None of its directors . . . are government officials or appointees. It receives no government funding . . ., [and] its actions cannot be imputed to the government."), *abrogated on other grounds by, United States v. Coppa*, 267 F.3d 132 (2d Cir. 2001); *United States v. Szur*, 1998 U.S. Dist. LEXIS 3519, *39-46 (S.D.N.Y. 1998) (rejecting defendant's claims that the NASD "acted pretextually in conducting their investigations"); *see also Marchiano v. National Ass'n of Securities Dealers, Inc.*, 134 F. Supp. 2d 90, 95 (D.D.C. 2001) ("[T]he court is aware of no case . . . in which NASD Defendants were found to be state actors either because of their regulatory responsibilities or because of any alleged collusion with criminal prosecutors.").

Testimony in an NASD proceeding may entail exposure to criminal liability, but that in itself is not enough to establish the requisite governmental nexus. *Shvarts*, 90 F. Supp. 2d at 222 (holding that "questions put to the defendants by the NASD in carrying out its own legitimate investigative

purposes do not activate the privilege against self-incrimination"). *Cf. United States v. Solomon*, 509 F.2d 863, 867-71 (2d Cir. 1975) (holding no violation of the Fifth Amendment where the government relied on testimony compelled in an earlier proceeding before the heavily-regulated New York Stock Exchange). To prevail, Cromwell must establish additional facts sufficient to satisfy the *Blum* test and to distinguish the present appeal from the general rule. *See Marchiano*, 134 F. Supp. 2d at 95 (finding no state action in Rule 8210 demand for testimony *absent actual evidence of governmental encouragement*).

Here, the district court found "no direct evidence of such governmental involvement," and that finding is not clearly erroneous. *D. L. Cromwell Inv., Inc. v. NASD Regulation, Inc.*, 132 F. Supp. 2d 248, 252 (S.D.N.Y. 2001). Cromwell invites a contrary inference from the chronology of certain events: (1) that the Rule 8210 demands followed shortly after individual appellants contested grand jury subpoenas; and (2) that the DOE refused to delay the Rule 8210 interviews until after completion of the Eastern District's criminal investigation. Similarly, Cromwell invites inferences of state involvement based on: (1) the administrative overlap between the Unit and the DOE; (2) the statement of an unidentified FBI agent to an individual appellant that "we are working with the NASD — they know exactly what is going on"; (3) questions posed by the DOE regarding two documents that Cromwell believes had been seized previously by the FBI; (4) the DOE's knowledge of certain government witnesses; and (5) the provision of the Fiserv grand jury subpoena permitting delivery of responsive documents directly to the Unit.

The district court, however, noted that these circumstantial inferences "perhaps would not be drawn so readily by those whose judgment is not tinged with self interest." *D. L. Cromwell Inv., Inc.*, 132 F. Supp. 2d at 252. The district court found that the DOE and the authorities pursued similar evidentiary trails because their independent investigations were proceeding in the same direction: the possibly improper trading in Pallet. The court was not surprised that federal investigators would say they were working with the NASD, or that the Unit occasionally served as a point of transfer for subpoenaed parties (to deliver requested documents to the FBI when the subpoenaed parties experienced technical computer difficulties): the Unit was in fact working with the government, and when it does it may well be a state actor. But though the Unit is a subdivision of Regulation, the district court found that the Unit's role (if and when it is a state actor) cannot fairly and automatically be imputed to the rest of the DOE, which, according to the district court, was effectively "walled off" from the Unit. *Id.* at 253. True, the district court found that the administrative wall was not impermeable; but it accepted Regulation's proffered indicia of good faith, and found no sinister counter-indications.

The Unit and the DOE staff members testified consistently that the Rule 8210 demands issued directly from the DOE as a product of its private investigation, and that none of the demands was generated by governmental persuasion or collusion — either directly or through the Unit. As Cromwell recognizes, the DOE has a regulatory duty to investigate questionable securities transactions. *See, e.g,* Plaintiffs' Reply Memorandum of Law in Support of Motion for Preliminary Injunction at 9, 9 n. 7, *D. L. Cromwell v. NASD Regulation,*

01 Civ. 728 (S.D.N.Y. Feb. 8, 2001) ("As associated persons active in the securities industry, [appellants] are well aware of . . . Regulation's lawful policing of the industry . . . [and] do not seek to have this Court exempt them from the regulation of Defendant."); *see also Szur,* 1998 U.S. Dist LEXIS 3519, at *39 (finding such a duty). The finding that it fulfilled that duty independent of governmental influence was not clearly erroneous. We need not address whether the record would have supported contrary findings, inferences and conclusions.

CONCLUSION

The judgment of the district court is affirmed.

APPENDIX B — MEMORANDUM OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED FEBRUARY 26, 2001

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

01 Civ. 0728 (LAK)

D. L. CROMWELL INVESTMENTS, INC., et al.,

Plaintiffs,

-against-

NASD REGULATION, INC.,

Defendant.

MEMORANDUM OPINION

LEWIS A. KAPLAN, *District Judge.*

Plaintiffs, all targets or subjects of a grand jury investigation in the Eastern District of New York, brought this action for an injunction barring NASD Regulation, Inc. ("Regulation"), the regulatory arm of the National Association of Securities Dealers, Inc. ("NASD"), from compelling the individual plaintiffs to testify in an investigation regarding the issuance and trading of shares in Pallet Management Systems, Inc. ("Pallet"), commencing any proceeding to punish the individual plaintiffs for asserting their privileges against self-incrimination in response to questions relating to Pallet, and

misusing federal grand jury materials to further its private disciplinary investigation. The case rests on the premise that Regulation is acting as the agent of federal prosecutors. The Court held an evidentiary hearing on plaintiffs' motion for a preliminary injunction at the conclusion of which it consolidated the trial on the merits with the hearing pursuant to Rule 65(a)(2) and with the consent of the parties.[1] This memorandum opinion contains the Court's findings of fact and conclusions of law.

Facts

Parties

Plaintiff D.L. Cromwell Investments, Inc. ("Cromwell") is a registered securities broker-dealer and a member of the NASD. The four individual plaintiffs all are employed by Cromwell.

Regulation is the regulatory arm of the NASD. Its Division of Enforcement ("DOE") conducts private investigations to ensure compliance with NASD rules and institutes disciplinary proceedings before professional hearing officers and regional District Business Conduct Committees ("DBCC") where appropriate. Sanctions imposed as a result of disciplinary proceedings are subject to many layers of review. Decisions of a DBCC may be appealed to the National Adjudicatory Committee ("NAC") of Regulation. NAC decisions in turn are subject to discretionary review by the NASD Board of Governors. Decisions may be reviewed further by the

1. Tr., Feb. 15, 2001 ("Tr."), at 117.

Securities and Exchange Commission,[2] which applies a *de novo* standard. The SEC's decisions in turn are reviewable in the United States Courts of Appeals.[3]

In 1998, Regulation formed a Criminal Assistance Prosecution Unit ("CPAG") within the DOE to provide assistance and advice to federal and state law enforcement authorities investigating securities matters. CPAG consists of one attorney, Bruce Bettigole, and an examiner and an investigator. CPAG staff are assigned to work exclusively in CPAG; they conduct no investigations or other enforcement activities on behalf of Regulation. Mr. Bettigole from time to time is designated a Special Assistant United States Attorney in one or another district to facilitate his cooperation with and participation in law enforcement activities. On occasion, and pursuant to court order, CPAG staff may be given access to grand jury materials pursuant to Federal Rule of Criminal Procedure 6(e). In those cases, CPAG staff members are not to disclose or discuss grand jury material with non-CPAG Regulation staff or, for that matter, with anyone not listed on the Rule 6(e) order. CPAG asserts that it does not use NASD rules to compel firms or associated persons to turn over documents to CPAG for the purpose of passing them on to law enforcement authorities.

Although the professed policy of Regulation with respect to CPAG and the rest of the DOE is one of complete separation of activities, the physical circumstances and administrative arrangements are not consistent with the policy. The head of

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2. 15 U.S.C. § 78s(d)(2).

3. *Id.* § 78y(a)(1).

the CPAG unit reports to a superior who supervises the DOE's investigatory functions as well. He shares a secretary with another lawyer who works on DOE private investigations. The CPAG examiner and investigator each have office cubicles in six-cubicle clusters, the other five occupants of each of which work on DOE investigations. CPAG shares telephone, fax and computer systems with the DOE. It has no locked file cabinets save a file drawer in the desk of the CPAG attorney. In short, the physical circumstances of CPAG and the DOE provide no assurance that confidential material in the hands of CPAG does not come to the attention of DOE investigators or that information concerning DOE investigations does not come to the attention of CPAG personnel. One is left to trust the good faith and judgment of the personnel involved.

The Hanover Indictment

Some time ago, a grand jury in the Eastern District of New York returned an indictment entitled *United States v. Cataggio*, a 53-defendant case relating to a firm called Hanover Securities. Mr. Bettigole of CPAG is serving as a Special Assistant United States Attorney in connection with that matter, and CPAG staff are assisting the U.S. Attorney's office. Two of the defendants, Thomas Plamenco and Joel Nazareno, are or were Cromwell brokers.

The Cromwell Investigations

In October 1998, the Market Regulation Department at Regulation referred Cromwell to the DOE for investigation.[4]

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4. Tr. 80.

The DOE assigned Scott Smith, an attorney, and John Lang, an examiner, to the matter.[5] Their inquiry related, at least in part, to trading activities in Pallet, and their first step was to seek trading records.[6]

Soon afterward, Pallet and, apparently, Cromwell became subjects of interest to the FBI and the United States Attorney for the Eastern District of New York. On November 16, 1998, the FBI made a written request to CPAG for access to its investigative files regarding Pallet, a request which some CPAG personnel appear to understand to have related to Cromwell.[7] A few days later, Ms. Walters of CPAG responded with a letter granting access and enclosing a number of documents relating to Pallet.[8]

In March 1999, after DOE obtained the Pallet trading records, it conducted an on-site inspection of Cromwell's books and records at its Boca Raton office.[9] Messrs. Smith and Long spent three days there and returned to their offices with Cromwell documents relating to Pallet.[10]

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5. *Id.* at 80-82.

6. *Id.*

7. DX I, Nov. 16, 1998 letter; *see* Tr. at 19, 40-41, 58.

8. DX I, Nov. 20, 1998 letter.

9. Tr. 80-83.

10. *Id.* at 83-84.

Appendix B

Not long after Messrs. Smith and Long returned from Florida, Mr. Smith received a call from the FBI during which he gave the agent a "general overview" of DOE's investigation and described the documents that had been gathered during the on-site inspection.[11] The agent asked for access to the documents, which resulted in Smith learning of the November 1998 letter from the FBI.[12] Once Smith was satisfied that the FBI had made a formal access request and that DOE had granted it, Long sent the FBI copies of a number of documents relating to Pallet and Cromwell,[13] documents that appear to have been obtained by DOE during its on-site inspection.

By the summer of 2000, matters had moved along. Prosecutors in the Eastern District had located a cooperating witness and, in July 2000, briefed the DOE on what the witness had to say.[14] In addition, the prosecutors and the DOE staff exchange general descriptions of their respective investigations, each learning that both were looking into matters relating to Pallet, albeit for different time periods.[15]

Some time later, the U.S. Attorney's office sought CPAG assistance in preparing an affidavit in support of an application

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11. *Id.* at 85.

12. *Id.* at 85-86; DX I.

13. DX A.

14. Tr. at 99-101.

15. *Id.*

for a warrant to search Cromwell's New York office. Mr. Bettigole assigned Mr. Melley, a CPAG staff member, to the task, and Melley provided the prosecutors with information from Regulation's central registration depository.[16] Following execution of the search warrant on September 7, 2000, Mr. Bettigole and the other of his CPAG subordinates, Ms. Manuel, went to Brooklyn to review the seized documents for the purpose of finding any material that related to Messrs. Nazareno and Plamenco, the defendants in the *Cataggio* case on which they were working.[17] Ms. Manuel returned to Washington with an inventory of what the FBI collected in the search of Cromwell's New York office and copies of some commission runs seized at that time.[18]

In November 2000, the DOE made a number of requests to Cromwell and associates for the production of documents.[19] By letter dated November 17, 2000, counsel for Cromwell and the others responded in part by stating that federal agents had seized many of Cromwell's business records, thus making it impossible to respond to most of the DOE's requests.[20] This prompted Mr. Scott, who was handling the DOE investigation, to request an inventory of the documents that had been seized both from the U.S. Attorney's office and

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16. *Id.* at 19-20.

17. *Id.* at 19-21.

18. *Id.* at 70.

19. DX B-C; *see* DX E.

20. DX D; Tr. at 89.

from Cromwell.[21] The U.S. Attorney's office responded that CPAG already had the inventory and, after Cromwell's counsel provided a copy of the inventory that was illegible or difficult to read, one of Mr. Smith's subordinates requested and received a legible copy from CPAG.[22]

Review of the inventory by DOE led to the conclusion that the U.S. Attorney's office had many of the documents that DOE had sought unsuccessfully from Cromwell. DOE staff obtained permission to review the product of the search warrant and, in January 2001, obtained copies of a substantial quantity of seized documents.[23]

In the meantime, in December 2000, prosecutors in the Eastern District obtained the assistance of Mr. Melley of CPAG in preparing a grand jury subpoena requiring an entity named Fiserv to produce trading data regarding Pallet. The subpoena, which was issued by a grand jury separate

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21. PX 2, ¶¶ 15-16.

    Before asking for inventories of the seized documents, Mr. Scott, who had heard that CPAG's Ms. Manuel had gone to Brooklyn to review them, described the nature of the DOE investigation to her and asked her whether she thought that the documents in Brooklyn were pertinent to it. Ms. Manuel referred him to her superior who in turn referred Scott to the U.S. Attorney's office. Tr. at 69-73.

22. *E.g.*, *id.* ¶¶ 17-19; Tr. at 64, 107-08.

23. *Id.* ¶¶ 20-21; PX 2, ¶ 21.

from the one that was involved with Hanover Securities, permitted the respondent to comply by producing the information to Mr. Melley rather than to the grand jury. Mr. Melley explained that this was done because the subpoenaed information can be supplied electronically to Regulation but cannot be so supplied to the U.S. Attorney's office or the FBI due to computer system differences.[24]

Recently, the DOE served Rule 8210 demands on Cromwell and the individual plaintiffs which purport to require them to submit to on-the-record interviews. As Regulation maintains that it is a private actor, it does not recognize the invocation of the privilege against self-incrimination by persons subject to its regulatory powers. Accordingly, there is a substantial likelihood that the invocation of the privilege by the individual plaintiffs to avoid giving evidence to DOE would result in disciplinary action against them, perhaps ultimately resulting in their permanent bar from the securities industry.

Plaintiffs' Claims

The individual plaintiffs contend that the Rule 8210 demands have been issued by Regulation as an agent for the government in order to coerce them into surrendering their privileges against self-incrimination by threatening them with permanent banishment from the securities industry if they decline to testify in the NASD investigation. All plaintiffs contend also that government criminal investigators have shared grand jury materials with Regulation in violation of Rule 6(e).

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24. PX 4, ¶ 6; Tr. at 60-62; *see also id.* at 36-38.

Appendix B

Discussion

The Rule 8210 Demands

The individual plaintiffs claim that they are faced with a Hobson's choice. If they invoke their privileges against self-incrimination to avoid testifying in Regulation's ostensibly private investigation, they claim that they will be barred from the securities industry or, at least, subjected to administrative sanctions. If they comply with the Rule 8210 demands, they risk incriminating themselves in the pending grand jury investigation. This dilemma, they claim, is unlawful because the Rule 8210 demands violate their Fifth Amendment rights.

The Fifth Amendment prohibits only governmental action.[25] The NASD and Regulation are private entities[26] save that Regulation is a state actor with respect to Mr. Bettigole's conduct in his capacity as a special assistant United States Attorney. Hence, even if the individual plaintiffs are being compelled to give evidence against themselves by the threat of NASD sanctions, Regulation's actions raise no Fifth Amendment issue unless it fairly may be said that its actions are fairly attributable to the government.[27] This in turn

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25. *Corrigan v. Buckley*, 271 U.S. 323, 330 (1926).

26. *See, e.g., Desiderio v. National Ass'n of Securities Dealers, Inc.*, 191 F.3d 198, 207 (2d Cir. 1999), *cert. denied*, 121 S.Ct. 756 (2001).

27. *Id.* ("A state is responsible for a private decision only where it exercised coercive power or provided significant encouragement.")

requires that the government have "exercised coercive power or . . . provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the" government or, at least, that "the private entity has exercised powers that are 'traditionally the exclusive prerogative of the State.' "[28]

There is no direct evidence of such governmental involvement. Indeed, all of the relevant Regulation personnel — i.e., all of those involved with the DOE investigation and every member of CPAG — flatly deny that the Rule 8210 demands are the product of any urging or suggestion by the United States Attorney's office or any other governmental agency. Plaintiffs nevertheless argue the Court should not credit that testimony and should infer that DOE is acting as the cat's paw of the government from a series of circumstances:

- Regulation issued Rule 8210 demands to two of the individual plaintiffs for personal financial records shortly after they and Cromwell received Eastern District grand jury subpoenas.

- In September 2000, during the search of one of Cromwell's offices pursuant to a search warrant, one of the individual plaintiffs expressed a desire to call the NASD to explain why the firm was not answering telephone calls of other market makers. An unidentified FBI agent is said to have stated that "we are working with the NASD — they know exactly what is going on."

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28. *Blum v. Yaretsky*, 457 U.S. 991, 1004-05 (1982) (quoting *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 353 (1974)).

- In January 2001, during investigational testimony of another Cromwell employee, the employee was questioned regarding two documents that plaintiffs "believe" were seized by the FBI and surmise were not produced by them to Regulation.

- The Fiserv grand jury subpoena gave the witness the opportunity to respond by delivering responsive documents to Mr. Melley at the NASD Washington office.

- Regulation has refused to adjourn the interviews until the completion of the criminal investigation.

One can appreciate the apprehension felt by those facing parallel civil and criminal investigations and the consequent tendency to draw inferences that perhaps would not be drawn so readily by those whose judgment is not tinged with self interest. One can appreciate also the wisdom of the old saw that sometimes even paranoids have people after them. But plaintiffs would have the Court draw conclusions from these circumstances that simply are unreasonable, especially in light of the uncontroverted explanations offered by Regulation.

Regulation has an independent obligation to investigate the matters at issue and is conducting its own investigation. While at first blush it appeared more than curious that a grand jury subpoena permitted compliance by delivery of the documents to Mr. Melley, the fact is that Mr. Melley works in CPAG, is working with the United States Attorney's office on the grand jury investigation, is designated to have access

to grand jury materials, and in any case was made the recipient of the documents only because the material subpoenaed was trading records that could be transmitted electronically to him at Regulation but could not be transmitted electronically to the FBI or the United States Attorney because of differences in computer systems.

Similarly, the alleged comment by the FBI agent during the execution of the search warrant, assuming that it was made, was benign given the context. The NASD — specifically CPAG — is working with the FBI on the grand jury investigation. No doubt those CPAG personnel detailed to that matter did know exactly what was going on. But that does not even remotely establish that there is any connection between the Rule 8210 demands and the government. Regulation has submitted extensive proof that its regulatory investigation is being carried out by the DOE, that there is no connection between that investigation and the grand jury investigation, and that the CPAG personnel are, figuratively speaking, "walled off" from the other activities of the DOE. The Court credits that evidence and finds that the Rule 8210 demands are not the product of any government coercion, suggestion or other action. Rather, they are the product of entirely independent action by the DOE staff conducting Regulation's private investigation of Cromwell and the trading in Pallet.

In a final bid to keep his case alive, plaintiffs' counsel referred at trial to cases disqualifying law firms from suing a former client where there is a risk of inappropriate use of the confidences of the former client,[29] an allusion to what now

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29. Tr. at 119-20.

is Canon 4 of the Code of Professional Responsibility and the substantial relationship test employed in its implementation. The substantial relationship test was formulated by Judge Weinfeld in *T.C. Theatre Corp. v. Warner Bros. Pictures, Inc.*[30] "to determine whether a lawyer's suit against a former client would risk violation of what is now Canon 4's protection of a client's confidences."[31] Reasoning that inquiry into whether and to what extent a current representation has compromised, or threatens to compromise, the secrecy of confidences of a former client — and thus destroy the very confidences the inquiry is designed to preserve — the Court presumed that confidences are threatened whenever counsel sues a former client on a matter that bears a substantial relationship to the prior representation.[32]

The analogy plaintiffs would draw between this situation and the substantial relationship test is flawed. The hard reality underlying the substantial relationship test is that the adoption of a presumption of abuse of former client confidences is the only manner in which the lawyer's duty to respect those confidences may be enforced without disclosing the very confidences the rule is designed to protect. There is no comparable difficulty here. Judicial inquiry into whether the Rule 8210 requests were the product of government suggestion or coercion did not require the disclosure of any

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30. 113 F. Supp. 265 (S.D.N.Y.1953).

31. *Glueck v. Jonathan Logan, Inc.*, 653 F.2d 746, 749 (2d Cir. 1981).

32. 113 F. Supp. at 268-69.

information in which plaintiffs or, for that matter, Regulation had a legitimate interest of confidentiality. Thus, there is no basis whatever for enjoining the Rule 8210 interviews.

Grand Jury Secrecy

Plaintiffs contend that if the Court determines, as it has, that Regulation is not a "state actor" with respect to its regulatory investigation, then there must have been a violation of Criminal Rule 6(e) because Regulation has used two documents seized by the FBI in questioning one of its employees.

There are a good many difficulties with this contention, but there is no need to deal with all of them. It suffices to say only this: there simply is no credible proof that any materials subject to Rule 6(e) have been disclosed to or used by Regulation personnel who have not been authorized by court order to have them. Plaintiffs' case rests on the belief of Cromwell's Ms. Monte that two documents she was shown during her NASD testimony had been seized during the execution of the search warrants and her inability to find a record of having produced those two documents pursuant to any Rule 8210 request. It is entirely likely that she in fact was shown documents seized pursuant to the warrant.[33] But plaintiffs have failed to show that those documents, seized pursuant to the warrant, were "matters occurring before the grand jury" and therefore within the protection of Rule 6(e).[34]

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33. *See* PX 2, ¶ 23.

34. *See* FED. R. CRIM. P. 6(e)(2). Information obtained independently of a grand jury examination does not come within the

(Cont'd)

Appendix B

As there is no evidence that Ms. Monte was shown any grand jury materials[35] or that any grand jury materials ever were disseminated beyond CPAG personnel authorized by court order to receive them, plaintiffs' Rule 6(e) argument fails.[36]

(Cont'd)
secrecy provisions of Rule 6(e) "simply because it may be presented to a grand jury in the future," *see United States v. Eastern Air Lines, Inc.*, 923 F.2d 241, 244 (2d Cir. 1991). Accordingly, in ordinary circumstances, information obtained pursuant to a search warrant, at least prior to any presentation of it to a grand jury, is not covered by the Rule. *See In re Grand Jury Subpoena (Under Seal)*, 920 F.2d 235, 241-43 (4th Cir. 1990) (information produced by a criminal investigation that parallels but is independent of grand jury investigation not subject to Rule 6(e)); *Anaya v. United States*, 815 F.2d 1373, 1379-80 (10th Cir. 1987) (same); *In re Grand Jury Matter*, 682 F.2d 61, 64-65 (3d Cir. 1982) (same); *see also In re Grand Jury Subpoena*, 103 F.3d 234, 238, 239 (2d Cir. 1996).

35. *Id.*

36. The foregoing assumes that plaintiffs sued the right party on their claim of a Rule 6(e) violation, which by no means is clear. Given the lack of proof of any violation, however, there is no need to address this issue.

Appendix B

Conclusion

As the foregoing demonstrates, there was a certain amount of contact between and among the government, CPAG and DOE staff concerning Cromwell in a period during which both the U.S. Attorney's office and DOE were conducting investigations of the company. While the Court has found that Regulation's DOE was not an instrumentality of the government in seeking these Rule 8210 interviews and that there was no violation of grand jury secrecy in this case, Regulation may wish to give careful attention to its arrangements concerning assistance to criminal investigations and to the relationships, both physical and administrative, between CPAG and the DOE. The present arrangements left doubt sufficient to require a trial as to the independence of DOE's 8210 requests in this matter, a situation that perhaps could have been avoided by more careful controls.

SO ORDERED.

Dated: February 26, 2001

s/ Lewis A. Kaplan
Lewis A. Kaplan
United States District Judge

APPENDIX C — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED MARCH 12, 2001

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

01 Civ. 0728 (LAK)

D. L. CROMWELL INVESTMENTS, INC., et al.,

Plaintiffs,

-against-

NASD REGULATION, INC.,

Defendant.

ORDER

LEWIS A. KAPLAN, *District Judge.*

Plaintiffs' motion for a new trial on the basis of alleged newly discovered evidence is denied. Assuming *arguendo* that the evidence is newly discovered notwithstanding due diligence on the part of plaintiffs and their counsel, it quite clearly would not have altered the result in this case. There has been no error of fact or law and no manifest injustice. See *LiButti v. United States*, 178 F.3d 114, 118 (2d Cir. 1999).

SO ORDERED.

Dated: March 12, 2001

s/ Lewis A. Kaplan
Lewis A. Kaplan
United States District Judge

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING DATED AND FILED MAY 8, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

* * *

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 8th day of May two thousand two.

01-7301

D.L. CROMWELL INVESTMENTS, INC., LLOYD BIERNE, DAVID S. DAVIDSON, ERIC S. THOMAS, and MATTHEW GREENWALD,

Plaintiffs-Appellants,

v.

NASD REGULATION, INC.,

Defendants-Appellees.

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant D.L. Cromwell, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

Appendix D

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

ROSEANN B. MACKECHNIE, Clerk

By: s/ Arthur M. Heller
Arthur M. Heller,
Administrative Attorney